

The local construction sector can ignite the fuse on SA's infrastructure renewal



Nicole Martens, Head of Stewardship, and Siboniso Nxumalo, Chief Investment Officer, Old Mutual Investment Group

The local construction sector has faced a number of challenges in recent years, led by a lack of infrastructure spend post the World Cup boom, the Covid-19 pandemic, a sharp economic downturn and ongoing energy woes, all of which has led to the significant shrinking of the sector. Yet, as highlighted by the current energy crisis facing the country, the construction sector has a critical role to play in the development of infrastructure to support solutions for SA's energy woes and therefore must be allowed to thrive.

Assessing the challenges and opportunities

The sector has struggled to push ahead with large infrastructure projects in recent years. Policy uncertainty remains a serious constraint and the industry has been further weighed down by slow progress in the awarding of crucial government and state-owned enterprises (SOE) tenders as well as the legacy of State Capture.

Poor infrastructure spend from the key SOEs were driven largely by lack of skills/expertise to execute on tender projects at the SOE's, lack of funding given the financial position of the SOEs and corruption. The private sector has been more buoyant. However, due to poor sentiment, private sector Gross Fixed Capital Formation/GDP has also been trending downwards. Private sector led Independent Private Power Producers (IPP) investments are therefore a positive theme for the construction sector going forward.

With the national agenda currently aligning around a just energy transition – not only due to global net zero commitments but now necessitated by limited coal powered energy capacity – new, sustainable approaches to consumption and production are emerging as a realistic solution. This is being underpinned by Eskom's energy plan and Transmission Development Plan. As we press into 2023, the government and its various SOEs are also focusing on the urgent need for infrastructure maintenance and upgrades – along with new projects – in sectors like electricity distribution and supply, roads, rail and sea transportation, and water and sanitation.

The construction sector, already under severe strain, cannot afford to lose any more of its larger listed players if it is to fulfil its role of driving the long overdue expansion and renewal of major economic and social assets.

The local construction sector can ignite the fuse on SA's infrastructure renewal

The role of asset allocators in creating a robust construction sector

The urgency surrounding the development of renewable energy infrastructure, while offering huge opportunity for the sector, also presents risk given the fast tracked development needed for energy production and the opening for governance abuse and compromises that this brings. To succeed they will need to have their house in order and their investors have a responsibility to ensure they reach their full potential to fulfil their critical role in the national agenda.

The interaction between allocators of capital, institutional investors and purposeful stewardship is often understated when it comes to empowering listed construction firms to play their part in South Africa's infrastructure renaissance. Asset managers and asset allocators, who hold key stakes in local construction companies, have a clear duty to help them address all the challenges currently facing the sector and this includes internal issues. This is beneficial not only to these companies but also to every South African who so desperately needs a functioning construction sector.

Real world impact of infrastructure expenditure

Government's current increased attention on infrastructure renewal creates the opportunity for a dialogue with financial institutions, NGOs and relevant private sector stakeholders to accelerate the approval and implementation processes for crucial infrastructure projects.

Due to the systemic importance of the sector, it has been prone to abuse in the past, however following the vast amount of investment in addressing and overcoming these abuses, we are now at a point where all of these stakeholders need to collectively keep up the momentum to ensure the old malignancies don't take hold again.

Once the mega projects have been agreed to support the energy crisis agenda, locally listed construction companies must play their part in capacitating the state to deliver. WBHO has an impressive portfolio of major projects spanning 50 years including the Gauteng Freeway Improvement Project; Greenpoint Stadium in Cape Town, the main civils at Kusile Power Station; the Kathu Solar Project; and the Mall of Africa, to name a few. Raubex is also highly regarded for its infrastructure and roads and earthworks capabilities, having delivered several significant solar installations in recent years. While they do focus on renewables, road construction is still their predominant focus area, with the Beitbridge border project, which is due for completion this year, being their most significant recent project.

Companies like these will be fundamental in addressing critical infrastructure issues and will certainly be involved in much of the renewable build to 'plug the gap' left by Eskom's ailing coal fleet. And with the help of active stewardship by investors, these companies are positioned to play their part in rebuilding the country's infrastructure within an ESG framework. The hope is that by building the capacity of the leadership of these companies to apply international best practice standards of governance, and fast tracking procurement, all South Africans will benefit from the GDP multiplier that large, listed construction firms offer.

However, mounting pressure on the government to address electricity supply constraints has raised concerns that large construction projects might be offshored to China (and others), further eroding the country's internal construction capabilities and contributing to jobs and skills losses across the sector.

We must therefore look at investments in the local construction sector from more than just a 'contract cost' or return perspective. Companies in this sector have served the nation well over decades, creating jobs; paying taxes; supporting local communities; and, of course, stimulating economic growth. The social costs of further delays in critical infrastructure projects should be factored in by the government, who should address the procurement 'hurdles' that are delaying our much needed infrastructure recovery.

As allocators of investor capital, our mandate remains to focus on the real world impact of infrastructure expenditure, and we believe that South African specific issues around employment, inequality, poverty and transformation are best addressed by supporting and protecting the country's internal capacity and capabilities.